

DOCUMENT RESUME

ED 460 582

EF 005 252

TITLE Guidelines for Programs for the Issuance of General Obligation Bonds by Missouri School Districts.

INSTITUTION Missouri State Dept. of Elementary and Secondary Education, Jefferson City.

PUB DATE 1996-07-31

NOTE 9p.

AVAILABLE FROM For full text:
<http://www.dese.state.mo.us/divschsvc/supervision/>.
Legal/Legislative/Regulatory Materials (090)

PUB TYPE

EDRS PRICE EDRS Price MF01 Plus Postage. PC Not Available from EDRS.

DESCRIPTORS *Bond Issues; Educational Facilities Improvement; *Educational Finance; Elementary Secondary Education; *Guidelines; Money Management; Public Schools; School Construction; School District Wealth; *State School District Relationship

IDENTIFIERS *Financing Options; *Missouri

ABSTRACT

The Missouri Health and Educational Facilities Authority has been legislatively directed to assist the state's school districts in the issuance of general obligation bonds and to develop guidelines for two voluntary methods relating to the issuance of these bonds. The program offered provides credit enhancement and helps achieve the lowest possible borrowing costs and other favorable borrowing terms for school districts in need of educational facilities. This document presents the guidelines on the basic program requirements and credit considerations, followed by guidelines for pool financing and conventional bond financing. (GR)

Division of School Services
Supervision

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GUIDELINES FOR PROGRAM FOR THE ISSUANCE OF GENERAL OBLIGATION BONDS BY MISSOURI SCHOOL DISTRICTS

I. BACKGROUND AND GOALS

In 1995 the Missouri Legislature adopted Senate Bill No. 301 (the "Law") creating Sections 360.106 and 360.111 of the Revised Statutes of Missouri. The Law directs the Health and Educational Facilities Authority of the State of Missouri (the "Authority") to assist Missouri school districts in the issuance of general obligation bonds. The Law charges the Authority, among other things, with developing Guidelines for, and the administration of, two voluntary methods relating to the issuance of general obligation bonds by Missouri school districts (the "Program"). The Program should provide credit enhancement and help achieve the lowest possible borrowing costs and other favorable borrowing terms for Missouri school districts in need of educational facilities.

The two voluntary methods provided for pursuant to the Program can be described as follows: (1) general obligation bonds may be issued on the conventional basis by individual school districts with the Authority serving as an administrator for access to the benefits of the Program (the "Conventional Bonds"); or (2) the Authority may issue bonds to the public, typically as part of a pool financing, using the proceeds of the sale of the Authority's bonds to purchase the bonds of individual participating school districts (the "Pool"). Both methods will receive equal attention and treatment by the Authority. An individual school district electing to participate in the Program can choose between the issuance of Conventional Bonds or the Pool.

School districts are not required to be involved in the Program but there are two incentives added by the Legislature to encourage such involvement. First, in an effort to improve the credit quality of all school districts in Missouri, the Law provides for credit enhancement by the direct deposit by the State of Missouri to a bank serving as trustee (the "Direct Deposit Trustee") of a portion of state aid payments that would otherwise be paid directly to the involved school district. The direct deposit would be equal to debt service on the school district bonds. This procedure is expected to result in a credit rating on the school district bonds based to a large extent on the credit quality of the State. Given the State's high credit rating, this should make school districts among the highest rated bond issuers. Second, to assist the school districts with the cost of educational facilities, the Program provides for the payment of certain bond issuance costs out of funds to be appropriated each year by the State of Missouri.

II. PROGRAM CONSIDERATIONS

A. Basic Program Requirements.

1. Application Form. Any school district interested in becoming involved in the Program must complete the form of Application attached hereto as Exhibit A and submit the same to the Authority. The Program is not open for involvement by junior college districts or entities other than Missouri school districts.

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2. General Obligation Bonds. The bonds issued by the school districts pursuant to the Program must all be general obligation bonds of the school districts. Such general obligation bonds must comply with all requirements of Missouri law applicable to such obligations including registration with the State Auditor if appropriate. Obligations of school districts other than general obligation bonds such as revenue bonds, leasehold bonds, certificates of participation and tax or revenue anticipation notes are not eligible for inclusion in the Program.
3. New Money or Refunding Bonds. The general obligation bonds of the school district may either be "new money" or "refunding" bonds. Any refunding or refinancing of existing bonds of the school districts must have significant net present value savings apart from the savings attributable to a payment from the State for the costs of issuance (i.e. savings will be determined assuming the school district will have to pay the costs of issuance itself). The calculation of the savings shall be reviewed for reasonableness. Reasons other than present value savings for a refunding or refinancing will be considered but, pursuant to the Law, there must at least be net present value savings of 1 1/2% of the par amount of the refunded bonds. The All Inclusive Cost (AIC) method should be utilized for the purpose of determining the discount rate to use to calculate net present value savings. AIC means as follows: that semiannual discount rate which equates future payments relating to the bonds including principal, interest, and associated expenses, to the net issue proceeds.
4. Intercept-Direct Deposit Arrangements. The Program provides for credit enhancement by an assured source of payment on the bonds (i.e. state aid payments). The bond documents will provide for school districts to agree to the direct deposit of a portion of monthly state aid payments (i.e. first dollar of state aid payments) to the Direct Deposit Trustee who will in turn remit to each appropriate paying agent the required principal and interest payments at the required times. This procedure should result in credit quality that is to a large extent tied to the State's ability to pay and in a high investment grade rating for bonds of school districts in the Program. Each school district will be required to enter into a Direct Deposit Agreement, in substantially the form of that attached hereto as Exhibit B (the "Direct Deposit Agreement"), at the time of issuance of its bonds as a precondition to involvement in the Program.
5. Payment of Costs of Issuance. Any school district which has a Direct Deposit Agreement in place on the date of issuance of its bonds will be eligible to receive moneys to be applied to the payment of certain costs of issuance with respect to the issuance of the Bonds (but with certain limits as to the Conventional Bonds as described below). The costs will be reviewed by the Authority to determine that they are fair and reasonable. Pursuant to the Law such costs may be paid only as to bonds issued for the purpose of financing construction or renovation projects approved by voters after January 1, 1995 or refinancing construction or renovation projects or for refinancing of lease purchase obligations with general obligation bonds.

Pursuant to the Law, in the event that there will be insufficient funds to pay all the costs of issuance in any one year, special preference shall be given to new money bonds over refunding bonds. Accordingly, with respect to refunding bonds, the payment of costs of issuance will not be made until late in the State's fiscal year when it has been determined by the Authority that there will be funds available to pay costs of issuance for all new money issues. Costs of issuance will be paid with respect to new money

bonds on a "first closed - first paid" basis.

The costs of issuance which can be paid include the fees and expenses of the underwriters, the attorneys, the printing, the paying agent, the State Auditor's registration, rating agency fees, and related costs. Payment of cost of issuance in the case of Conventional Bonds shall be by the issuance of a single check to the applicable school district upon authorization by the commissioner of education and a certification by the school district pursuant to the Law.

6. Coordinate Closing With Direct Deposit Arrangements. All bonds in the Program, both Conventional Bonds and Pool Bonds, shall be closed on a date necessary to accommodate direct deposit arrangements with the payment schedule on the bonds consistent with the timing demands of the Program and satisfactory to the applicable rating agencies.

No debt service payments on school district bonds will be payable in the months of June, July and August of any year.

7. Coordinate With State Departments. The Authority shall work with the Missouri Department of Elementary and Secondary Education ("DESE"), the Office of Administration and the Treasurer's Office to coordinate the Program and the direct deposit of state aid payments in the best interest of Missouri school districts. The Authority will use its best effort to coordinate with the aforesaid entities and the rating agencies so that a school district will be advised of its eligibility for involvement in the Program within thirty days of receipt of its Application.
8. Executive Director To Act For Authority. All actions to be taken by the Authority and all communications with the Authority, with respect to the Program, shall be through the Executive Director of the Authority at the Authority's office in St. Louis, Missouri.
9. Direct Deposit Trustee. The Authority will select a Direct Deposit Trustee following a Request For Proposal process. It will be a Missouri institution having corporate trust powers. The institution could also serve as paying agent as to Conventional Bonds and/or bond trustee as to a Pool.
10. Authority Charges. As permitted by the Law, the Authority will charge an annual or other periodic fee as an administrative cost for work by it on the Program. This will be paid out of amounts annually appropriated by the State. The Authority will not charge an issuing school district a fee or any other amounts for its assistance relative to the issuance of Conventional Bonds or Pool Bonds. Accordingly, the administrative cost of the Authority will not apply against the two percent limit applicable to Conventional Bonds.
11. Obligations Binding On School Districts. Section 360.106(12) of the Law requires the Authority to review the cost effectiveness of the Program and provide an annual report to the General Assembly on the Program, the Authority's findings, and a recommendation of whether the Program should be repealed, strengthened or otherwise amended. Any school district bonds issued pursuant to the Program will not, as a general matter, be negatively impacted by subsequent legislative structural changes to the Program (e.g. as opposed to changes in the amount of state aid) because the parties

will be bound to make payments on the bonds and as to the pledge of state aid by the Law and documentation in effect at the time of issuance of their bonds.

B. Program Credit Considerations.

1. Program Rating - Rating Agencies. The Authority will work with one or more of the national credit rating agencies to achieve a "program" rating for school districts in the Program which meet the minimum credit criteria. The Authority will assist the school district in the initial rating process by providing to the rating agencies the information submitted by the district to the Authority along with its Application to the Program. School districts involved in the Program will be required to provide certain information to the applicable rating agencies on an annual basis such as an annual audit, budget and other information reasonably requested.

2. Coverage Requirements. To achieve a satisfactory "program" rating, school districts will need to have a minimum level of "coverage" of state aid payments relative to that district's debt service in the Program. The coverage required is that in the fiscal year of issuance, as well as in the two fiscal years prior to the year of issuance, of the school district's bonds, the state aid payments to the involved school district must be at least two times the maximum annual debt service on the school district's bonds which are the subject of the "program" rating. The coverage calculation does not include debt service on school district obligations which are not the subject of the direct deposit procedure.

The state aid payments will be pledged by the school districts to cover its debt service. Any pledge by school districts in the Program of their state aid to subsequent non-Program debt or other obligations will not have a prior or parity lien to that of Program debt.

3. Rating May Not Be Required. The Authority will not necessarily require that Conventional Bonds or Pool Bonds obtain a "program" rating if the Authority can be persuaded that a rating is not beneficial or justified to obtain a suitable financing for the particular school districts. For example, a "program" rating might not be obtained if: (a) a school district does not receive enough state aid to meet the coverage test and thus cannot achieve a "program" rating; (b) a school district can receive an adequate rating based on its own credit strength; or (c) it is clearly not cost justified to obtain a "program" rating such as for a very small privately placed issue. It is, however, anticipated that a school district's bonds would be rated if they are being issued on a parity with prior bonds that are rated.
4. "Shadow" Rating of Districts. A "shadow" or separate rating of each school district from a rating agency may or may not be required as a condition for obtaining a "program" rating. Of course, a school district may need to, or may choose to, obtain a separate rating for itself in connection with its bonds which are part of the Program. This may be particularly true for a school district which has prior rated general obligation bonds outstanding which are not part of the Program. Further, it is possible that a given school district's general obligation debt may have one rating for bonds issued pursuant to the Program and another rating for its bonds which are not part of the Program.

5. Monthly Payments From State. Payments from the State to the Direct Deposit Trustee

for payment to the appropriate paying agent of the "first dollar" of state aid payments owed to the school district, shall be in approximately ten equal monthly increments of annual debt service beginning in the month of the "bond year" necessary to assure a satisfactory "match" with the debt service schedule on the bonds. In a typical situation with debt service payments every six months after closing on the bonds, the first deposit would be in the month of closing of the bonds. If, however, a short coupon or long coupon arrangement were allowed by the Authority and any applicable rating agencies, the bond year dates for deposited payments may need to be set up differently. Thus, the appropriate deposit formula will be established at the closing of the bonds. There will be no debt service payments on the school district bonds prior to six months from the date of issuance, except when due to unusual circumstances agreed to by the Authority and any applicable rating agencies.

If, for whatever reason, any monthly payment is not made or is not made in full, it shall be made up out of the next payment of state aid with respect to the School District (i.e. if any school district's 1/10 payments to the Direct Deposit Trustee are not on schedule, the next successive monthly payment would be that month's 1/10 payment plus the prior months' shortfall).

6. Credit Enhancement. The Authority will analyze each issuance as to whether the benefits of third party credit enhancement (e.g. bond insurance) outweigh the costs of purchasing the same. For example, interest cost savings on the bonds due to the credit enhancement must at a minimum exceed the cost of any credit enhancement paid for out of cost of issuance funds provided by the State.
7. Contact Rating Agencies. The Authority will, within a reasonable period of time, contact any rating agency which has provided a "program" rating with information regarding any changes in Missouri law affecting state aid, the Law or the school funding formula. The Authority will also annually provide such rating agency with a copy of its report to the General Assembly required pursuant to Section 360.106(12) of the Law at the time it provides a copy to the General Assembly. The Authority will also provide any other information reasonably requested by a rating agency. Any school district receiving a "program" rating will provide information to the rating agencies as to material changes in its state aid and any other information reasonably requested by a rating agency. The Authority will use its best efforts to cause DESE to notify rating agencies as soon as available each year of state aid payments and debt service payments for all districts in the Program for the year completed and budgeted numbers for the upcoming year.
8. Investments. In connection with both Conventional Bonds and the Pool, any state aid payments made to the Direct Deposit Trustee shall be invested by the Direct Deposit Trustee as directed by the Authority until transfer to the individual paying agent/bond trustee. Such transfer shall be three days prior to when debt service payments are due on the school district bonds. Investments shall be made through the Direct Deposit Trustee in order to maximize investment return, assure security and resolve any applicable rating agency concerns. Investments by the Direct Deposit Trustee must be consistent with applicable state law and shall be in investments approved by applicable rating agencies. Earnings on the investments will be paid by the Direct Deposit Trustee to the applicable school district at least once each year.

Further, in connection with both Conventional Bonds and the Pool, bond proceeds will not be held by the Direct Deposit Trustee but will be held for the benefit of the school districts as traditionally held in such transactions. Investments of such funds must be consistent with applicable state law and shall be in investments approved by applicable rating agencies.

III. CERTAIN CONSIDERATIONS ONLY AS TO POOL FINANCINGS

A. Guidelines Unique to Pool Financings.

1. Authority To Issue Periodically. The Authority will issue bonds for the Pool to purchase the bonds of participating school districts as often as the demand dictates to make the Pool economically feasible.
2. No Cross-Collateralization. Obligations of the participating school districts in the Pool shall not be cross-collateralized. No school district's state aid payments shall be used for the proportionate debt service of any other school district. The bond documents will be clear that there shall be no liability of any sort of one school district for another's debt service or other obligations.
3. Program Rating. It is contemplated, though not required, that all bonds issued by the Authority with respect to the Pool will apply for and meet the state aid to debt service coverage and other requirements necessary to obtain the "program" rating. Some of the bonds in the Pool might not obtain a "program" rating and may not be equally rated in the event that: (a) a school district does not receive enough state aid to meet the coverage test; or (b) the school district can obtain an equal or higher rating on its own. The Authority will not enter into a Direct Deposit Agreement on unrated debt if it causes any involved school district's prior Program bonds to fail to meet the above Program coverage requirements, without the consent of the applicable rating agency.
4. Use of Various Service Providers. The Authority contemplates going through a competitive bid process for the selection of the following services in connection with the issuance of the bonds for the Pool over an initial two-year period and annually thereafter.
 - a. Bond Counsel. The Authority will select a Missouri firm to serve as Bond Counsel as to the Authority bonds following a Request For Proposal process. The Firm will be primarily responsible for preparation of bond documents and structuring the transaction from a legal standpoint.
 - b. Legal Opinion On School District Bonds. The Authority's Bond Counsel will also be willing to serve as Bond Counsel and provide necessary proceedings, documents, bond resolutions and legal opinions with respect to the individual participating school district's general obligation bonds at no additional charge to the school district. Alternatively, the participating school district may employ a separate bond counsel firm to do this work, but at its own expense.
 - c. Senior Managing Underwriters. The Authority will develop a list of approved underwriters with a substantial Missouri presence following a Request For Proposal process. Individual participating school districts can request an

individual firm on the approved list to serve as Senior Manager on its portion of the pooled bonds and the Authority will consider this request but shall retain final discretion as to the selection of Senior Manager(s). If there is more than one Senior Manager in any Pool, the Authority shall select the bookrunning manager.

- d. Co-Managers. The Authority will select Co-Managing underwriters for each issuance of bonds from among the firms on its approved list of underwriters. The Authority will strive to see that the Senior Manager(s) and Co-Managers receive compensation on a fair and equitable basis. The Authority is willing to attempt to set the compensation prior to the commencement of a Pool financing.
- e. Underwriters/Disclosure Counsel. The Authority will prepare a Request For Proposal for Underwriters/Disclosure Counsel and the Authority will select a Missouri law firm to serve in that role. The law firm will primarily be responsible for preparing the Official Statement and other underwriting documents in connection with the sale of the bonds.
- f. Printers. Any printers needed in connection with the preparation of the Official Statement or the bonds would be selected by the Authority following a Request For Proposal process.
- g. Bond Trustee. The Authority will select a Bond Trustee following a Request For Proposal process. This will be a Missouri institution. It could be the same as the Direct Deposit Trustee.

IV. CERTAIN CONSIDERATIONS ONLY AS TO CONVENTIONAL BOND FINANCINGS

Guidelines Unique to Conventional Bonds.

1. Authority Not Required to Select Service Providers. In connection with Conventional Bonds, the Authority is not required by the Law to be involved in the selection of service providers such as Bond Counsel, Underwriters/Disclosure Counsel, Underwriters, Printers or Bond Trustee. The Authority is, however, happy to assist any school district, at no charge, in the selection of any or all of these service providers. It is expected that firms with a substantial Missouri presence will be used for all of these services except in unusual circumstances.
2. Five Sale of School District Bonds. The Authority would require that the successful bidder in any competitive sale of bonds would certify the amount of its underwriter's discount (as well as any original issue discount or other amounts received). Only the amount of the certified underwriter's discount would be payable out of the costs of issuance moneys appropriated by the State. Other appropriate costs of issuance could also be paid (e.g. bond counsel, printing, etc.).
3. Limitation on Payment of Costs of Issuance. The Law provides that the maximum amount of payment of costs of issuance for the Conventional Bonds shall be two percent. Of course, all costs will be reviewed to determine that they are fair and reasonable.
4. Independent Paying Agent. The paying agent with respect to Conventional Bonds must

- be a Missouri bank or trust company selected by the school district and cannot simply be the school district itself.

5. Operations Procedures Memorandum. Attached hereto as Exhibit C and incorporated by reference herein is an Operations Procedures Memorandum reflecting certain procedures to be followed in connection with the issuance of Conventional Bonds.

V. CONCLUSION

The Law requires that the Authority review the cost effectiveness of the Program and report to the Missouri General Assembly on the Program with recommendations as to the legislation by January 15 of each year.

The Authority reserves the right to review and modify these Guidelines as needed in the sole discretion of the Authority to effectuate the purposes and goals of the Law.

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Missouri Department of Elementary and Secondary Education

Division of School Services -- Supervision

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Revised July 31, 1996